

The McNulty Memorandum

Introduction

On December 12, 2006, the Department of Justice (“DOJ”) released the “McNulty Memorandum,”¹ which “supersedes and replaces the guidance contained in the Memorandum from Deputy Attorney General Larry D. Thompson, entitled Principles of Federal Prosecutions of Business Organizations,” otherwise known as the “Thompson Memorandum.”² This action followed increasing criticism from Congress, the American Bar Association (“ABA”), the National Association of Criminal Defense Lawyers and a broad coalition of legal and business groups that sought to curtail aggressive prosecution tactics against corporations in the post-Enron world.

Two recent events appear to have played a part in convincing the DOJ that change was necessary. First, in the high profile KPMG fraud investigation, Southern District of New York Judge Lewis Kaplan harshly criticized the government for pressuring KPMG to cut off legal fees for its employees. Judge Kaplan held that in doing so the

government violated the individuals’ constitutional rights and he urged KPMG to consider paying those fees.³ The final straw appears to have occurred on December 7, when Senator Arlen Specter, with Senator Patrick Leahy as a co-sponsor, proposed new legislation entitled “The Attorney-Client Privilege Protection Act of 2006” which “seeks to protect the sanctity of the attorney-client relationship by forcing the Department of Justice to revise its corporate charging policies” as embodied in the Thompson Memorandum.⁴ Under the shadow of Senator Specter’s proposed legislation, the DOJ announced the release of the McNulty Memorandum. According to the DOJ, the purpose of the McNulty Memorandum is (i) to create stricter approval requirements before federal prosecutors may request corporations to waive attorney-client and work product protections; and (ii) to place additional limits on whether a prosecutor can consider a refusal to such a request when determining whether to charge the corporation.

- ¹ Memorandum from Deputy Attorney General Paul J. McNulty, to Heads of Department Components, United States Attorneys regarding “Principles of Federal Prosecutions of Business Organizations” (December 11, 2006) (“McNulty Memorandum”), *available at* http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf.
- ² Memorandum from Deputy Attorney General Larry D. Thompson, to Heads of Department Components, United States Attorneys regarding “Principles of Federal Prosecutions of Business Organizations” (January 20, 2003). (“Thompson Memorandum”), *available at* http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm.
- ³ United States v. Stein, 2006 WL 3327594 (S.D.N.Y. Nov. 13, 2006).
- ⁴ *Media Notice: Specter Press Conference on Attorney-Client Privilege*, released by the United States Senate Committee on the Judiciary on December 7, 2006.

Momentum for Change

Critics of the Thompson Memorandum argued that the culture of routine requests for waiver and corresponding “voluntary” waivers by corporations trying to get “credit” for waiving their privilege even before being asked, discouraged open and frank communication between legal counsel and corporate employees, who justifiably feared the potential for government intrusion into their communications. Business leaders also complained that these practices were making it more difficult to enforce fraud detection policies because employees were less willing to come forward and corporate legal counsel feared creating a paper trail that could ultimately fall into the hands of prosecutors and plaintiffs’ lawyers. Finally, some critics argued that it was improper to pressure corporations to stop paying legal fees for their employees who had decided to exercise their constitutional rights not to incriminate themselves.

This past summer, the ABA passed Resolution 302B which criticized the government’s practices under the Thompson Memorandum as eroding the Constitutional and other legal rights of employees, including decisions to enter into or continue operating under a joint defense and information sharing agreements, to share information with employees and agents relating to the matters under investigation by the government, or to choose to retain or decline to sanction an employee who exercised his or her Fifth Amendment rights.⁵

Has Anything Changed?

Attorney-Client Privilege

Despite the DOJ’s efforts to promote the McNulty Memorandum as a major change in direction, it remains to be seen whether real

change will occur. While recognizing that the attorney-client privilege is “one of the oldest and most sacrosanct privileges under U.S. law,” the McNulty Memorandum continues to allow federal prosecutors to request such waivers from corporations “when there is a legitimate need.” In evaluating whether there is a legitimate need, a prosecutor is directed to consider:

1. the likelihood and degree to which the privileged information will benefit the government’s investigation;
2. whether the information sought can be obtained in a timely and complete fashion by using alternative means that do not require waiver;
3. the completeness of the voluntary disclosure already provided; and
4. the collateral consequences to a corporation of a waiver.

Given the lenient nature of these considerations, it is hard to imagine circumstances in which a federal prosecutor could not find that a legitimate need exists.

The McNulty Memorandum creates two categories of waiver. Category I information is defined as “purely factual information, which may or may not be privileged, relating to the underlying misconduct.” Federal prosecutors must first request Category I information. Category I waiver requests require written authorization from the United States Attorney who must also “provide a copy of the request to, and consult with, the Assistant Attorney General for the Criminal Division.” Category II information is defined as “attorney-client communications or non-factual attorney work product.” Prosecutors

⁵ ABA Presidential Task Force on Attorney-Client Privilege, Recommendation 302B (Aug. 2006), *available at* <http://www.abanet.org/media/docs/302Brevised.pdf>.

are “cautioned that Category II information should only be sought in *rare* circumstances.” In addition to authority from the United States Attorney, requests for Category II information also require written authorization from the Deputy Attorney General.

Historically, the DOJ has usually requested what is now defined as Category I information, so the tiered approach which makes obtaining Category II information more difficult may have little impact in practice. It remains to be seen how the authorization process will work.

Federal prosecutors are still authorized to consider a corporation’s response to a Category I information waiver request when determining whether to charge the corporation. Accordingly, it is still within the prosecutor’s discretion to consider the refusal of such a request when making charging decisions. Though prosecutors are directed *not* to consider a refusal to waive Category II information, they are authorized to still consider positively a corporation’s decision to waive. Obviously, corporations will feel pressure to agree to the waiver of Category II information since an agreement will provide additional potential protection against prosecution.

Legal Fees

The McNulty Memorandum also addresses the legal fees issue highlighted by the KPMG case. Prosecutors are still directed to consider whether the corporation “appears to be protecting its culpable employees and agents.” However, they are now instructed that they “*generally* should not take into account whether a corporation is advancing attorneys’ fees to employees or agents under investigation or indictment.” The McNulty Memorandum recognizes that many corporations are constrained by state law or contractual obligations to pay legal fees, and therefore, a corporation’s compliance with such obligations should not be considered a failure to cooperate,

but there are limits to that directive: “[i]n extremely rare cases the advancement of attorneys’ fees may be taken into account when the totality of the circumstances show that it was intended to impede.”

Frequently, a corporation is authorized, but not mandated by law, to advance fees and does so only as a matter of practice rather than as a matter of legal obligation. The McNulty Memorandum does not address whether it will consider following such a practice to constitute non-cooperation. It was the government’s pressure on KPMG to deviate from its practice that drew the ire of Judge Kaplan in Stein. Given the impact of the Stein case in changing the culture of government pressure with respect to the payment of individual attorneys’ fees, it is reasonable to expect that the DOJ will not routinely hold it against a corporation for following a practice of paying fees, even if not mandated by law or contractual obligation. It is often in a corporation’s interest to ensure that its individual directors, officers and employees are well represented. The McNulty Memorandum may be a first step in allowing corporations to assist its individuals in retaining counsel without putting itself at risk of prosecution.

Finally, the McNulty Memorandum does not address at all DOJ pressure on corporations to terminate “uncooperative” employees. Thus, individuals may remain at risk for losing their job as a consequence of exercising their constitutional right against incriminating themselves. Senator Specter’s proposed legislation explicitly forbids the DOJ from rewarding a corporation for terminating an employee for exercising his or her constitutional rights.

Conclusion

Hopefully, the McNulty Memorandum signals a shift in the DOJ’s attitude, thinking and approach to these issues. Certainly the DOJ appears to have recognized that it can go too far in its enforce-

ment efforts and that, it is not in its interest to make fraud prevention efforts more difficult for corporations. To that end, we hope that the DOJ will be more selective in determining when and how it goes about seeking corporate waivers.

It remains to be seen how the McNulty Memorandum will work in practice. It provides cover for federal prosecutors who wish to continue pressuring corporations to waive their privileges and to cease paying legal fees. Accordingly, corporate lawyers will still need to be very careful about the extent and nature of their internal investigations and the types of paper trails they create. Moreover, unlike the legislation proposed by Senator Specter which seeks

to protect corporations who pay their employees' legal fees and corporate employees who exercise their Fifth Amendment rights, the McNulty Memorandum's impact on the payment of fees is uncertain, while it allows federal prosecutors to continue to pressure corporations into taking action against non-cooperating employees. The corporate community should follow closely the progress of the proposed legislation, which may or may not be slowed by the issuance of the McNulty Memorandum. It currently appears that despite the McNulty Memorandum, Senator Specter intends to re-introduce his legislation in January with a Democratic co-sponsor.

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